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## 4 Review of Scottish Business Surveys

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### Abstract

Business surveys are a useful tool and provide accurate and timely data that are extremely helpful in pinpointing subtle movements in the economy. Business surveys collect information on a wide range of topics such as business confidence, orders, turnover, exports, investment, employment etc. and when analysed provide a view of the overall economy. They are also useful for short term forecasting and pinpointing turning points. Many business surveys use net balances, determined by subtracting the percentage reporting declines from the percentages reporting increases. A number of recent surveys show that more and more businesses report that net trends, although remaining positive, have eased somewhat (with a growing number of respondents reporting 'no change') nevertheless most remain above pre-recession levels.

### Bank of Scotland Purchasing Managers' Index (PMI)

The Purchasing Managers Index (PMI) for Scotland (a single-figure measure of the month-on-month change in combined manufacturing and services output) in January 2015 saw output fall for the first time in 28 months from 52.8 in December to 47.7. This was the first sub-50 reading since September 2012, indicating a contraction, with output declines recorded for both manufacturers and services firms. The December PMI showed that Scotland's private sector economy ended 2014 in a fairly strong position with the index unchanged in December from November's 52.8. The November index indicated weakening growth, with the index easing from 54.2 in October to 52.8.

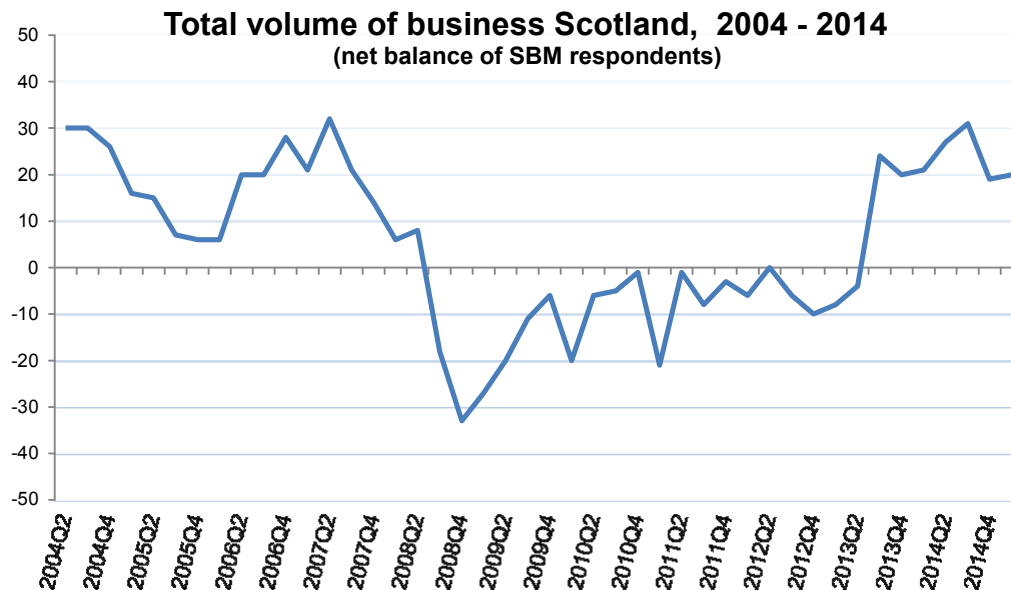
### Bank of Scotland Business Monitor

The latest Bank of Scotland Business Monitor, September, October and November 2014 (with expectations to May 2015) shows that the Scottish economy continued to grow at pre-recession rates although the speed of the recovery has eased. However, expectations for the next six months remain strong.

Turnover improved in the three months to the end of November 2014 for a net balance of +16%, although this was down from the +30% of the previous quarter, it remains higher than recent historic averages. The net balance of turnover has been positive for six consecutive quarters and according to the Bank of Scotland this therefore indicates growth.

In this Commentary we track the net balance in the total volume of business as reported in the Bank of Scotland Business Monitor, from 2004 Q2 to present (2014 Q4) – refer Figure 1. This clearly shows declines in the pre-crisis period (from 2007 Q2), moving into negative territory from 2008 Q3 and remaining in negative territory 2013 Q2. Though there was an improvement up until early 2010 the next two and a half years saw the Monitor indicate that the Scottish economy was largely stagnating. During mid-2013 the Business Monitor showed that the economy was beginning to grow again. This recovery continued into 2014 and respondents are forecasting good prospects for growth in 2015.

Thought growth continued during 2014, the rate of increase eased. The net balance of turnover for production firms during the three months to end November 2014 was +12%; down from +35% the previous quarter - but is identical to the +12% of the same quarter one year ago. Services businesses reported a net balance of turnover for the three months ending November of +19%, down on the +27% of the previous quarter and up on the +17% of the same quarter one year ago.



Source: Bank of Scotland Business Monitor

Exporting is proving a challenge in the face of stagnant Eurozone economies and the Business Monitor reported a recovery in export activity over the previous three Business Monitors. However more - a net of -4% of - firms reported a decline in export orders in the three months to the end of November 2014.

The trend in firms' own expectations rose through 2013 and into the first part of 2014 and although these expectations have been slightly tempered they are still above pre-recession levels. Indeed the latest Monitor was the eighth successive Business Monitor to show a positive net balance for turnover expectations – the most optimistic sequence of results for seven years, since 2008. A net balance of 19% expect turnover to rise in the six months to the end of May 2015, marginally lower than the +21% of the previous quarter but up on the +16% of the same quarter one year ago. On balance service firms are more than twice as optimistic as production companies, with a net balance of +24% of service firms expecting their turnover to increase compared to only +11% of production firms. In the summer 2014 Business Monitor, expectations for future export activity improved to its second highest level in almost seventeen year history of the survey. However the latest net balance for export activity for the next six months has significantly eased (from +32% to +5%).

Capital investment had been on a rising trend in previous quarters rising from +3% in the summer 2014 Monitor to +7% however a net of -6% expect a decline in the six months to May 2015.

The main findings from the latest Monitor are that economic activity continues to improve although expectations have fallen slightly but remain close to pre-recession levels. This suggests therefore that the recovery will continue into 2015 but the rate of growth will ease.

## **Manufacturing**

There was an increase in business optimism among Scottish Chamber Quarterly Business Survey (QBS) firms for the 9<sup>th</sup> consecutive quarter with a small net balance of 5% reporting a rise. Total orders rose for a net balance of 13% of firms. The survey also reported that export orders from within the EU were more subdued than those outwith the EU, as shown by a net balance of 4.3% of firms achieving increased EU orders compared with an increase of 13.1% for ex-EU export orders. A net balance of 14.3% firms expect export revenue to increase further in Q1 2015. Fewer than 10% of QBS manufacturing firms reported that levels of total employment had declined and fewer than 5% expect a reduction in total employment levels in 2015.

Scottish Engineering Review respondents in Q4 2014 reported that optimism, in general terms, continued to be positive for small and medium sized companies (SMEs) but large companies reported a decline. The trend in total order intake improved in Q4 with small companies remaining as being the most positive. The net trend in UK orders was positive and across economic sectors, electronics, oil and gas and mechanical equipment were positive whereas fabricators and metal manufacturing reported negative net balances. Forecasts for the next quarter of UK orders in general predict a further improvement. Electronics and metal manufacturing are predicting negative growth but fabricators and mechanical equipment are looking at growth in the future. The trend in export orders remained negative, though the rate of decline has eased. Predictions for the next three months in general are upbeat with SMEs expecting the trend in export orders to rise. Both capital and training investment trends remained positive and are expected to remain so. Trends in total employee numbers improved in Q4 and a further rise is forecast.

## **Construction**

Business confidence among QBS construction firms improved in Q4 compared to Q3, with a net balance of 23% of firms reporting increased optimism. A net balance of 38% reported a rise in total contracts, and the net balance of public sector contracts was at its highest level (+15.2%) for almost 8 years. Investment levels among QBS firms were at the highest level in 10 years as a net of 15% reported an increase in capital investment. Almost 40% of firms increased wages over the quarter and average wage increases continue to be above inflation, at 5.5%.

The latest Scottish Construction Monitor, a quarterly survey of the membership of the leading trade body, the Scottish Building Federation reported that business confidence rose by 15 points to +26% in Q4 2014. The Scottish Construction Monitor survey asked a number of questions focusing of skills shortages asking firms to pinpoint the region or regions where their business operates in order to build a profile of skills requirements across the country. Some of the key findings were that carpentry and

joinery skills were generally in short supply, notably with firms in the North East particularly and there is also a general shortage of bricklayers across Scotland as a whole.

## Retail

The Scottish Retail Sales Monitor conducted by The Scottish Retail Consortium and KPMG reported that total Scottish sales decreased by 2.3% in January 2015 compared to January 2014 when they had increased by 4.3%. This followed the decline of 1.8% in December 2014 compared with December 2013, when they had decreased by 1.1%. The report indicated that like-for-like sales decreased by 3.1% in January 2015 compared to January 2014 and by 2.6% in December 2014 compared to December 2013.

The Scottish Chambers Quarterly Business Survey reported a decline in business optimism in Q4 with a net balance of 4% reporting a fall in confidence. Sales, however improved for a net balance of 8% and a net of 10% expect a further rise in Q1 2015. Sales are expected to improve in the longer term with a net balance of 19% of firms expecting sales revenue to increase over the next year. However, these improving sales trends are not expected to lead to an increase in profits.

## Tourism

QBS firms continued to report a net rise in tourism optimism (+12%). 80% of hotels reported that the number of guests / customers was up compared to the same period in 2013. Almost half of hotels reported an increase in customers from the EU compared with Q3, with only 3% reporting a decline in visitors from outside the UK over the same period. A net balance of 18% of QBS respondents reported an increase in profits during Q4 2014 and more than one third expect profits to rise in Q1 2015; 56% expect an increase in profits over the coming year. Although fewer firms are recruiting, compared to the same quarter of the previous year, fewer than 5% expect to reduce their overall employment over the coming year.

## Outlook

Taken together these latest set of Scottish business surveys show a more cautious outlook that suggest that the Scottish economy may struggle to build upon its earlier momentum, with many trends falling from near record highs but still remaining well above long-run averages. Many expectations suggest that economic activity will continue albeit at a more modest pace in the first half of 2015. Expectations for 2015 are generally higher than their pre-recession levels but more and more firms are expressing a degree of caution and increasing uncertainty.

Fewer businesses are as confident about their prospects as they were last quarter. There is widespread uncertainty surrounding the Scottish economy at the moment and these results should be seen in the context of a largely unpredictable UK General Election, coupled with uncertainties across the Eurozone and the UK's relationship with the EU. This uncertainty and the slow growth seen in the Eurozone, plus restrained growth in the global economy, has clearly affected Scottish exports. However on a more

positive note, the fall in oil and other commodity prices should help ease businesses' cost pressures and, by boosting consumer incomes, help boost economic growth.

In conclusion, recent Scottish business surveys show that firms remain broadly upbeat about recent and near future business prospects with many trends still rising albeit perhaps slightly below comparable surveys in 2014. Scottish business surveys continue to indicate that growth in output and jobs remains fairly robust and many trends remain broadly favourable, although early indications are that the pace of recovery may be slowing and the degree of uncertainty in both the UK and the rest of the global economy is having an effect on Scottish businesses.

Lloyds TSB Business Monitor Issue 67, November 2014 – February 2015

Scottish Chambers' Quarterly Business Survey, Q4 2014

Scottish Engineering Quarterly Review, Q4 2014

The Bank of Scotland Markit Economics Regional Monthly Purchasing Managers' Indices (PMI), November 2014 – January 2015

The Scottish Retail Consortium's KPMG Monthly Scottish Retail Sales Monitor, January 2015